

U.S. House of Representatives
Committee on the Judiciary

Washington, DC 20515-6216

One Hundred Eleventh Congress

March 3, 2009

BY FACSIMILE AND POST

The Honorable Timothy F. Geithner
Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary,

Last Monday, February 23, 2009, I and several of my colleagues wrote to you with important questions about the Administration's "Homeowner Affordability and Stability Plan" and legislation pending in the House to implement key components of that plan (H.R. 1106). Our questions focused on the most troubling aspects of the plan, including the proposal to allow bankruptcy judges to rewrite home mortgages during bankruptcy. We stated clearly our concerns that the Administration's proposal to allow modifications of home mortgages in bankruptcy will lead to: (1) significant taxpayer liability for federal mortgage guarantees, redistributing wealth from responsible taxpayers to irresponsible borrowers and lenders; (2) the hoarding by banks of hundreds of billions of dollars in capital, undermining the efforts that have been undertaken by the Treasury and the Federal Reserve since September 2008 to stabilize our financial markets; and (3) the additional chilling of the home lending market.

Last week, we asked that you and the Administration work with us on a bipartisan basis to carve out of the pending legislation the roughly two-thirds of outstanding mortgages controlled or guaranteed by Freddie Mac, Fannie Mae, the FHA, and other federal entities. We have yet to receive your response.

I recognize the delay may signal that you share our concerns about the negative impacts this proposal will have on responsible homeowners and are working to address these concerns. If that is the case, I would like to reiterate the desire to work with the Administration to limit the scope of this legislation to ensure that the 92 percent of responsible homeowners who are working to pay off their mortgages are not forced to subsidize the mistakes of irresponsible borrowers and lenders.

In fact, over the past few weeks, there has been a groundswell of opposition to this proposal from the general public and the media, including calls for modern-day Boston Tea Parties across the country. This popular outrage is rooted in the belief that it is patently unfair

¹ See, e.g., Jonathan V. Last, *Gonna Have a Tea Party: Opposition to the Foreclosure Bailout Rises*, *The Weekly Standard* (March 9, 2009 ed.) (available at <http://www.weeklystandard.com/Content/Public/Articles/000/000/016/219pmhcs.asp>).

for Congress and the President to bail out favored mortgage-holders and mortgage lenders on the backs of responsible homeowners who continue to pay their mortgages even in these troubled economic times. Clearly, the American people are not willing to pay for their neighbors' irresponsible actions.

Even supporters of the cram-down proposal now recognize the need to limit the scope of the legislation. Secretary of Housing and Urban Development Shaun Donovan has again joined the chorus of those emphasizing that the legislation must be carefully tailored, and he has further stressed that the Administration does "not see bankruptcy courts as the place to work out mortgages."² Likewise, Senator Durbin has expressed his willingness to embrace a limitation of the legislation to subprime loans,³ and a growing number of economists and other opinion-makers have weighed in against the current proposals.⁴

But the burden placed on responsible homeowners is not the only aspect of this bill that is troubling. Section 102 of the bill seeks to prohibit bankruptcy courts from allowing lenders to bring mortgage-based claims in bankruptcy if the claims are based on principal residence mortgages "subject to a remedy for rescission under the Truth in Lending Act." A mortgage can be subject to a right of rescission under the Truth in Lending Act for technical violations as small as a misstatement of finance costs by \$35.00 over the life of the loan, a characterization of a charge as a "fee" instead of a "finance charge," or the provision of one copy of a Truth in Lending Act disclosure statement rather than two. Yet section 102 of the bill would require a bankruptcy court to deny a lender's claim on a mortgage if such a violation were shown. What is more, under the corollary, pre-existing provisions of 11 U.S.C. sec. 506, the lender's *very lien* on the home would be extinguished. In other words, section 102 would convert the Bankruptcy Code into a means of obtaining *a free home, unencumbered by any mortgage*, for anyone who can prove a violation of the Truth in Lending Act that gives rise to a right of rescission.

This is light years beyond the remedy available under the Truth in Lending Act itself for the same violation. Granted, a claim of rescission under that Act requires the lender to relinquish its right to the home as collateral for a loan. At the same time, however, the borrower must *return the funds loaned by the bank*. In short, both parties to the transaction are returned to the status quo ante, and thus made whole. A borrower does not get a free home, and a lender does not irretrievably lose the money it lent for the home's purchase.

² Tami Lubny, *Housing Fix's Bankruptcy Plan under Fire*, CNN Money (March 1, 2009) (available at http://money.cnn.com/2009/03/01/news/economy/obama_cramdown_plan/index.htm); cf. Timothy Geithner and Shaun Donovan, *Housing plan's aim: Help people help themselves*, USA Today (Feb. 19, 2009) (the Administration's plan must be crafted, at most, "to carefully change the bankruptcy law" for "hard-working families who have run out of options") (available at <http://blogs.usatoday.com/oped/2009/02/housing-plans-a.html>).

³ Senator Durbin has since claimed that he was misquoted as embracing this position. The evidence, however, both on audiotape and in a written transcript, is unmistakably to the contrary. See, e.g., *Transcript of Remarks of Senator Durbin*, American Banker (Feb. 27, 2009) (available at <http://www.americanbanker.com/article.html?id=20090227PTPDVCKZ>).

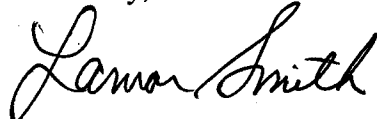
⁴ See, e.g., Robert J. Samuelson, *Wrong Turn on Housing*, Washington Post (March 2, 2009) (available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/03/01/AR2009030101581.html>); Editorial, *Call Them Irresponsible*, The Wall Street Journal (March 2, 2009), available at <http://online.wsj.com/article/SB123595305743805193.html>; Jeffrey A. Miron, Commentary: Bailing Out Homeowners Is a Mistake, CNNPolitics.com (March 2, 2009) (available at <http://www.cnn.com/2009/POLITICS/03/02/miron.housing.bailout/index.html>).

But bad as this unfair trap door in H.R. 1106 already seems, that is not all. Section 101 of the bill is written specifically to confer the bill's benefits on owners of million-dollar homes. As a result, by virtue of sections 101 and 102, *mansion owners* will be offered the means of getting *free mansions* – all on the backs of the innocent taxpayers who are being asked to provide the economic backing for the bill.

These provisions of the bill are unquestionably unfair and offer enticements that increase the likelihood that H.R. 1106 will undermine the Presidents' and others' programs to foster voluntary mortgage-workouts outside of bankruptcy. What homeowner wouldn't be tempted to take their home into bankruptcy, rather than a voluntary workout program, if by scouring their loan for technical Truth in Lending Act violations they could find the key to *a free home with no mortgage?* And what consumer bankruptcy attorney would not be tempted to encourage such abuse?

In sum, H.R. 1106, as currently drafted, is a profoundly unfair and unsound bill. I trust that you will see the bases for the concerns that I and others have brought to your attention, and I await your immediate response to this letter and the letter of February 23, 2009.

Sincerely,

A handwritten signature in black ink that reads "Lamar Smith". The signature is fluid and cursive, with the first name "Lamar" and last name "Smith" clearly distinguishable.

Lamar Smith
Ranking Member
House Judiciary Committee

cc: The Honorable Shaun Donovan
The Honorable Ben S. Bernanke